Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FCC 95-198

In the Matter of	)	
	)	
Policy and Rules Concerning Rates for Dominant Carriers	)	CC Docket No. 87-313
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: May 5, 1995; Released: May 18, 1995

COMMENTS DUE: July 3, 1995
REPLY COMMENTS DUE: July 24, 1995

By the Commission:

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I. INTRODUCTION

1. In this Further Notice we initiate a further examination of our regulation of services provided by AT&T Corporation (AT&T) subject to price cap treatment and, in particular, the regulation of AT&T's residential services. We seek comments on, among other things, our tentative conclusion that promotional tariffs and optional calling plans (OCPs) should remain subject to price cap regulation to the extent described herein. These issues have been addressed in two separate proceedings. In the Notice of Proposed Rulemaking in CC Docket No. 87-313,[1] the Commission sought comments on its tentative conclusion to remove promotions from price cap regulation. In the Notice of Proposed Rulemaking in CC Docket No. 93-197,[2] the Commission sought comment on, among other

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[1]Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order and Notice of Proposed Rulemaking, 8 FCC Rcd 3715 (1993) (*Promotions NPRM)*.

[2]Revision to Price Cap Rules for AT&T, CC Docket No. 93-197, Notice of Proposed Rulemaking, 8 FCC Rcd 5205 (1993) (*OCP NPRM*). The Commission also proposed a number of other changes to the price cap rules in the *OCP NPRM*, including whether to remove commercial, 800 Directory Assistance, and analog private line services from price caps. In the Report and Order in CC Docket No. 93-197, 10 FCC Rcd. 3009 (1995) (*Commercial Services Price Cap Order*) the Commission resolved these issues, removed commercial services from price cap regulation, and deferred the question of the regulatory treatment of OCPs to this proceeding.

issues, whether to remove OCPs from price cap regulation. Due to the commonality of the issues presented in determining the regulatory treatment of promotions and OCPs, we consolidate these issues here in one Further Notice of Proposed Rulemaking for further consideration.

2. This Further Notice also asks for comment on a broader range of issues than were raised in either of the earlier Notices in both dockets. Although we will consider the earlier records in these dockets, we invite commenters to supplement the record by addressing all of the issues raised herein. Specifically, we go beyond the earlier proceedings in both dockets to seek comments on our tentative conclusions regarding the regulatory treatment, described in detail below, that we would accord to all AT&T's Basket 1 services.[3] Our tentative conclusions also address issues raised in AT&T's petition for waiver of the price cap rules, which is pending before the Commission.[4] In addition, we tentatively conclude that we should revise the treatment of AT&T's exogenous costs to conform to the revisions that we adopted in the *LEC Price Cap Performance Review Report and Order*.[5]

3. Price cap regulation is designed to mirror the efficiency incentives found in competitive markets, thus acting as a transitional regulatory scheme until the advent of substantial competition makes price cap regulation unnecessary.[6] One purpose of the revisions on which we seek comment below is thus to provide a regulatory framework that will better serve the transition to further streamlining of AT&T's price cap services. AT&T has asked the Commission to rule that AT&T is a non-dominant carrier and, accordingly, should be permitted to remove all of its services from price cap regulation.[7]

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[3]*See* paras. 4-7, *infra*, for an explanation of price caps regulation and Basket 1. Although the earlier proceedings in both dockets involved OCPs, a service category in Basket 1, and promotions for certain Basket 1 services, they did not address all the services in Basket 1.

[4]AT&T Corp. Petition for Waiver of Price Cap Rules to Allow AT&T to Bring the LDMTS Basic Schedule NPA Volume Discount Option Under Price Caps (filed May 17, 1994) (*AT&T Price Cap Waiver Petition*).

[5]Price Cap Performance Review for Local Exchange Carriers, First Report and Order, CC Docket No. 94-1, FCC 95-132 (rel. April 7, 1995) (*LEC Price Cap Performance Review Report and Order*.

[6]*See id.* at ¶ 1.

[7]*See* Motion for Reclassification of American Telephone & Telegraph Company as a Nondominant Carrier, CC Docket 79-252 (filed Sept. 22, 1993).

II. BACKGROUND

4. In 1989, the Commission replaced rate-of-return regulation of AT&T with an incentive-based system of regulation, known as price caps, for most of AT&T's telecommunications services.[8] The Commission stated that price caps would encourage efficiency and innovation while decreasing the incentive for AT&T to shift costs from more competitive to less competitive service offerings.[9] Under this system, prices are capped rather than profits. Thus, the plan gives AT&T the incentive to earn potentially higher profits if it can operate more efficiently, for example, by reducing its costs. To implement the price cap system, the Commission defined three categories of AT&T services, or baskets, and defined a price cap index (PCI) for each basket.[10] The basket structure is designed so that AT&T will not be able to raise prices for services in one

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[8]Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987) (*Price Cap NPRM*), Further Notice of Proposed Rule Making, 3 FCC Rcd 3195 (1988) (*Further Notice*), Report and Order and Second Further Notice, 4 FCC Rcd 2873 (1989) (*AT&T Price Cap Order*), Erratum, 4 FCC Rcd 3379 (1989), *on reconsideration*, 6 FCC Rcd 665 (1991) (*Reconsideration Order*), *remanded sub nom. American Telephone and Telegraph Company v. FCC*, 974 F.2d 1351, 1353 (D.C. Cir. 1992) (*Remand Order*). Those services that are not in price caps are subject to streamlined regulation, which reduces their regulatory obligations under Part 61 of the Commission's Rules. Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd 5880 (1991) (*Interexchange Order*), *on reconsideration*, 6 FCC Rcd 7569 (1991) (subsequent history omitted).

[9] *Price Cap NPRM*, 2 FCC Rcd at 5213.

[10]The three baskets were comprised respectively of: (1) residential and small business services; (2) "800" number services; and (3) other business services. Recently the Commission removed Basket 1 commercial services from price cap regulation. *See* note 2, *supra*. In addition, a number of AT&T services are excluded from price cap regulation, including: (1) services offered pursuant to Tariffs 11, 12 and 16; (2) services subject to below-the-line accounting; (3) international private line and record carrier services; (4) contract-based tariffs; and (5) the custom tariff services removed from price cap regulation pursuant to CC Docket No. 90-132. *See* 47 C.F.R. § 61.42 (c). Services subject to below-the-line accounting are services that AT&T is not able to operate at a profit, such as KU Band Satellite and Accunet Packet Services. Custom tariff services are services such as Software Defined Network that AT&T provides to large business customers.

basket in order to lower prices for dissimilar services in another basket.[11] Thus, a change in rates in one basket or in services outside price caps does not affect either the PCI or the actual price index (API) for the other baskets. The PCI for each basket imposes a price ceiling for the services in that basket. In order for the Commission to determine whether rate levels exceed the PCI, AT&T must compute and file for each basket an actual price index (API), which represents a weighted average of actual prices of the services within the basket.[12] PCIs and APIs are adjusted each year in AT&T's annual price caps filing to reflect the annual productivity offset of 3 percent and exogenous cost changes.[13] In addition, the API is computed for every tariff transmittal that includes a rate change.

5. AT&T may change rates for services within each basket subject only to streamlined scrutiny, provided that the weighted average of all those prices remains below the cap.[14] Under streamlining, the tariff filing is presumed lawful and may take effect on 14 days' notice without extensive cost support data. If, however, the proposed rate change would push a basket API above the cap, AT&T is required to file the change on the statutory maximum notice period of 120 days and to provide a full cost-based showing for such filings.[15]

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[11]*See also Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Service under Price Cap Regulation*, CC Docket No. 94-1, FCC 95-49 (rel. February 15, 1995).

[12]*See Reconsideration Order*, 6 FCC Rcd at 665-66, for an explanation of how the price cap index is calculated.

[13]Exogenous costs are costs that change due to changes in laws, regulations, or rules, or other administrative, legislative, or judicial changes beyond a carrier's control and are not reflected in the GNP-PI. *Further Notice*, 3 FCC Rcd at 3383 n.738.

[14]In addition to setting limits on the aggregate rates within each basket, the Commission also instituted rate bands to limit the range within which AT&T could raise or lower individual rate element prices each year while continuing to receive streamlined tariff scrutiny. *AT&T Price Cap Order*, 4 FCC Rcd at 3077, *citing Further Notice*, 3 FCC Rcd at 3440.

[15]*See AT&T Price Cap Order*, 4 FCC Rcd at 3109-11.

6. Basket 1 is further divided into service categories, or bands.[16] In the *AT&T Price Cap Order* the Commission concluded that "banding by service category, rather than by rate element, will give AT&T the flexibility it requires to allocate costs and price efficiently, while still protecting customers from large rate increases and rate churn."[17] An individual service band index (SBI) is established for each service band. SBIs for all service bands are calculated each year in AT&T's annual price caps filing. In addition, for any price cap tariff filing proposing changes in the rates of service categories, AT&T must calculate an SBI value for each affected service category.[18]

7. AT&T's Basket 1 historically has included toll services targeted to residential and small business customers. We recently removed AT&T's Basket 1 commercial services from price cap regulation and made them subject to streamlined regulation.[19] As a result, Basket 1 currently is divided into six service categories, all of which include primarily residential services.[20] Residential services have been the object of special Commission concern since the beginning of price cap regulation, when it sought to balance concerns for economic efficiency with the need to minimize the possibility of cross-subsidization and predation and to foster competition that would benefit all ratepayers.[21]

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[16]Baskets 2 and 3 also were divided into service bands or categories. A number of Basket 2 and 3 services were removed from price cap regulation and are now subject to streamlined regulation. As a result, Basket 2 currently contains only 800 Directory Service, and Basket 3 contains analog private line offerings, including analog voice grade private line and terrestrial television transmission service. *See* 47 C.F.R. § 61.42(a)(2)-(3).

[17]*Id.* at 3059.

[18]*See* 47 C.F.R. § 61.43 (annual price cap filings required) and 47 C.F.R. § 61.47 (adjustments to the SBI; pricing bands).

[19]*See Commercial Services Price Cap Order*, 10 FCC Rcd. at 3011.

[20]Basket 1 includes the following service categories: (1) domestic day message telecommunications service (MTS); (2) domestic evening MTS; (3) domestic night/weekend MTS; (4) international MTS; (5) operator and credit card service; and (6) ReachOut America (OCPs). *See* 47 C.F.R. § 61.42(b). ReachOut America was the original OCP that comprised category 6. Currently, most OCPs for domestic MTS are in the ReachOut America service category. *See infra* at notes 62 & 64 and accompanying text.

[21]*See AT&T Price Cap Order*, 4 FCC Rcd at 3051-52, 3059-60; *see also Interexchange Order*, 6 FCC Rcd at 5908 (noting need for "particular caution" in streamlining residential and small business services).

The Commission recognized that residential customers are significant users of day, evening, and night/weekend MTS.[22] The pricing for evening and night/weekend MTS, which are predominantly used by residential customers, originally was subject to an upward band limit of four percent per year.[23] In addition, we barred AT&T from increasing the average rate paid by residential customers for services in Basket 1 by more than one percent per year relative to the change in the PCI.[24]

8. An integral part of the price cap plan is a periodic review of the working of the plan to determine whether it is functioning as the Commission intended and in accordance with the Communications Act. Accordingly, the Commission adopted a program that combines ongoing monitoring of the price cap plan with periodic formal reviews. The Commission undertook the first performance review, as scheduled, in 1992.[25]

9. As a result of that review, the Commission determined that, while overall the price cap plan is achieving its intended goals, some adjustments to the plan might enhance its effectiveness.[26] Accordingly, the Commission initiated another proceeding to determine whether the price cap plan should be revised in four specific areas.[27] In particular, the FCC sought comment on whether to remove commercial services, 800 Directory

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[22]*AT&T Price Cap Order*, 4 FCC Rcd at 3059. We will refer to AT&T's non-discounted pricing in these three bands throughout this Further Notice as the "basic schedule" of residential service rates.

[23]*Id.* at 3060; 47 C.F.R. § 61.47(f).

[24]*AT&T Price Cap Order*, 4 FCC Rcd at 3060-61; 47 C.F.R. § 61.47(f)(2).

[25]Price Cap Performance Review for AT&T, Notice of Inquiry, CC Docket No. 92-134, 7 FCC Rcd 5322, 5323 (1992).

[26]Price Cap Performance Review for AT&T, Report, 8 FCC Rcd 5165 (1993) (*AT&T Performance Review Report*).

[27]Revisions to Price Cap Rules for AT&T, CC Docket No. 93-197, Notice of Proposed Rulemaking, 8 FCC Rcd 5205 (1993) (*OCP NPRM*). In addition, the Commission requested more information from AT&T regarding AT&T's Equipment Failure and Blockage Reports, which track AT&T's service quality and network reliability. The Commission recently adopted a Report and Order on the issues other than OCPs that were raised in the *OCP NPRM*. *See Commercial Services Price Cap Order*, FCC 95-18, note 2, *supra*, in which the Commission resolved these issues and deferred the question of the regulatory treatment of OCPs to this proceeding.

Assistance, analog private line service, and optional callings plans (OCPs) from price caps.[28] The Commission did not address AT&T's promotional offerings in this proceeding. In the recently released *Commercial Services Price Cap Order*,[29] we removed AT&T's commercial services from price caps regulation. In that Order, we stated that "AT&T demonstrates both in its comments and through additional information submitted in the record of this proceeding that there is sufficient evidence to conclude that AT&T's commercial long distance services are subject to substantial competition." We stated that ". . . our analysis rests on considerations of market share, demand responsiveness and supply responsiveness. As the result of this analysis, we conclude that AT&T lacks the ability to exercise unilateral market power in the provision of these services and that there is sufficient competition among providers to justify moving AT&T's commercial services from price caps to streamlined regulation."[30] We concluded, however, that 800 Directory Assistance should remain under price cap regulation because it ". . . remains a monopoly service and therefore it is necessary to regulate the price for this service to protect consumers."[31] Further, we concluded that analog private line services should remain under price caps regulation because "none of the parties has presented any evidence that the situation has changed since the Commission's 1991 decision in the *Interexchange Proceeding*."[32] We stated that "[t]he Commission concluded that the market for these services was not as competitive as the market for other services offered by AT&T and

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[28]Streamlined regulation was adopted for Basket 3, except for analog private lines, effective in October 1991. *Interexchange Order*, 6 FCC Rcd at 5894 and 6 FCC Rcd 7255 (Com.Car.Bur. 1991). Streamlining of Basket 2, except for 800 Directory Assistance, took effect in May 1993 following the successful deployment of the technology for 800 number portability. "Portability" refers to 800 number subscribers' ability to retain their 800 numbers when switching their 800 service from one IXC to another. The Commission ordered local exchange carriers (LECs) to implement technology to make such portability possible no later than March 4, 1993. *Interexchange Order*, 6 FCC Rcd at 5905-06, *citing* Provision of Access for 800 Service, CC Docket No. 86-10, 6 FCC Rcd 5421, 5425 (1991). In response to petitions of the Ad Hoc Telecommunications Users Committee and the Financial Services Providers, the Commission granted a three-month delay, until May 1, 1993, for implementing the mandatory 800 data base access. Provision of Access for 800 Service, CC Docket No. 86-10, 7 FCC Rcd 8616 (1992).

[29]*Commercial Services Price Cap Order*, 10 FCC Rcd. at 3011.

[30]*Id.* at 3014.

[31]*Id.* at 3023.

[32]*Interexchange Order*, 6 FCC Rcd at 5895.

therefore required continued oversight under price caps."[33] We deferred to this consolidated proceeding further consideration of the removal of OCPs from price caps.[34]

A. AT&T Promotions

10. A promotion usually involves a discounted offering of an existing tariffed service or service category to a particular sub-class of customers for a limited period of time.[35] For example, promotions might be limited to customers in a particular geographic area, to customers that historically have achieved a specified level of monthly usage, or to new subscribers.[36] Thus, while the basic rates for a service remain in effect and apply to some customers of a service, other customers of that service may be paying a discounted rate for a specified period of time. In other instances, all customers of a service may receive the discounted rate for a specified time, and then revert to the basic rates when the promotion expires.[37]

11. The Commission was silent in the *AT&T Price Cap Order* as to the treatment of promotional rates under price caps. After the Commission adopted the price cap rules, AT&T filed a significant number of promotions in which it treated the rates associated with these offerings as rate reductions for purposes of API calculations. MCI Telecommunications Corporation (MCI) and Sprint Communications Company LP (Sprint) sought reconsideration of the *AT&T Price Cap Order*, requesting clarification of the treatment promotional pricing activities should receive under price caps.[38] In the *Reconsideration Order*, the Commission decided to exclude promotional tariffs from the price cap index prospectively. It reasoned that including promotional rates in price caps would give AT&T too much flexibility to change prices within Basket 1, which contained

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[33]*Commercial Services Price Cap Order*, 10 FCC Rcd. at 3024.

[34]*Id.* at 3011.

[35]On occasion, AT&T's promotions alternatively have provided, among other things, long distance gift certificates or points to be redeemed for merchandise and travel.

[36]*Reconsideration Order*, 6 FCC Rcd at 671.

[37]For example, AT&T offered a discount off Reach Out World service during December 24, 1994 through January 31, 1995 to customers who originate calls from Hawaii. AT&T Communications Tariff F.C.C. No. 2, Transmittal No. 7856 (effective Dec. 24, 1994).

[38]*Reconsideration Order*, 6 FCC Rcd at 671.

residential and small business rates.[39] Although the Commission decided to exclude promotions from price caps, it also stated that "as long as a promotional offering does not raise discrimination issues or otherwise fail to comply with the Communications Act, we will not limit AT&T's efforts to generate greater network efficiencies by restricting promotional activity."[40]

12. In its appeal of the *Reconsideration Order*, AT&T asked the court to vacate the Commission's decision to exclude promotional offerings from price caps as arbitrary and capricious because the Commission failed to explain adequately its change in the treatment of promotional rates.[41] The court agreed with AT&T, finding that the Commission's decision to exclude promotional tariffs from the price cap index was not a reasoned decision supported by the record. The court remanded the *Reconsideration Order* to the Commission with instructions either to show that its action is a clarification of the original *Price Cap Order*, despite the evidence AT&T presented to the contrary, or to "offer a reasoned explanation of why promotional rates should be treated differently from other rates."[42]

13. In response, the Commission vacated its prior decision on this issue and issued the *Promotions NPRM* in Docket 87-313, in which it tentatively concluded that promotions should be excluded from price cap regulation prospectively.[43] The Commission offered several reasons to support this proposal. First, a basic purpose of price caps is to assure a reasonable basic schedule of long distance rates for ratepayers. Although price cap regulation is designed to reward efficiency by granting carriers flexibility in pricing individual services, the Commission had rejected a price cap system that would have granted AT&T unlimited flexibility to increase basic schedule rates to offset promotional rate decreases.[44] The Commission reasoned that "[i]f AT&T is allowed to take index credit for promotions, its actual price index (API) would decrease. As historically has

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[39]The Commission subsequently removed commercial services from price cap regulation. *Commercial Services Price Cap Order*, 10 FCC Rcd. at 3011.

[40]*Reconsideration Order*, 6 FCC Rcd at 670.

[41]*See Remand Order*, 974 F.2d at 1353.

[42]*Id.* at 1355.

[43]*Promotions NPRM*, 8 FCC Rcd at 3717.

[44]*Id.* at 3716, *citing Reconsideration Order,* 6 FCC Rcd at 665-69 (Commission established baskets and bands to limit pricing flexibility).

been the case, AT&T could then increase its API by increasing general schedule rates." The Commission tentatively concluded that:

> permitting promotional offerings to be used as a basis for raising basic schedule rates, without limitation, would strongly encourage the proliferation of excessive promotional offerings and undercut the efficiency incentives of the price cap program. For example, AT&T could attempt to promote its services to customers of other IXCs with the promise of interim rate cuts or long distance gift certificates, and then protect its revenue stream by increasing rates in the basic MTS schedule for existing customers. . . . In other words, AT&T could offer promotions when it needed to raise general schedule rates to cover its inefficiencies even though price cap regulation is designed to provide an incentive for companies to operate more efficiently.[45]

The *Promotions NPRM* further reasoned that "since one of the fundamental purposes of price cap regulation is to put AT&T on a more equal competitive footing with other IXCs, allowing AT&T to insulate itself from revenue losses caused by promotional pricing undercuts one of the basic goals of price cap regulation."[46] The Commission concluded that "[i]f AT&T operated in a completely competitive market, this issue would be moot because AT&T could not raise general schedule rates without the fear of losing customers to a competitor."[47]

14. The Commission thus tentatively concluded that "allowing AT&T to offset rate reductions for promotional offerings against increases in the basic rates could undercut the Commission's enforcement mechanism for price cap regulation."[48] For example, under price cap rules, if AT&T were to file an above-cap tariff, the filing would be subject to full regulatory scrutiny and possible suspension.[49] The potential problem, however, as

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[45]*Id.* at 3716. This reasoning assumes that a rate increase would offset the depressive effect that such an increase would have on demand and that AT&T basic schedule customers would not respond to such increases by switching to another carrier.

[46]*Id.*

[47]*Id.* at 3716 & n.14. This reasoning assumes that the existing rates reflected competitive levels.

[48]*Id.* at 3716.

[49]*See* para. 2, *supra.*

described by the Commission in the *Promotions NPRM,* is that if AT&T were to file a promotional tariff that decreased rates for certain services within Basket 1, the API would be lowered for the duration of the promotion, thus allowing AT&T to raise rates within the basket for other services without exceeding the basket's PCI. When the promotion expired, however, the API would rise and prices for some services within the basket could be left above cap for the period of time between the expiration of the promotion and the next AT&T rate filing that proposed rates above the PCI.[50] Because the promotion had expired, however, the Commission could not investigate it in order to deter unreasonable, above-cap rates for the basket.[51]

15. As an alternative, the Commission sought comment on whether to treat promotional tariffs as either new or restructured services.[52] Under price cap regulation, a service is classified as new if it provides an additional option to a service, but does not replace the existing service. Conversely, a service is classified as a restructured offering if it replaces an existing service.[53] Rates for restructured services are immediately incorporated into the price cap calculations upon effectiveness of the tariff. Rates for new services, however, are not incorporated into the price cap calculations until the first annual price cap tariff filing following completion of the base period in which they are introduced.[54] At that point, actual revenues and demand data for the service are available. A promotion resembles a new service because it provides a new option, a discount from the existing basic schedule, which does not replace the existing service. On the other hand, a promotion differs from a new service, in that it restricts the availability to eligible customers and limits the time during which those customers may subscribe to the promotion. New services are generally available and may be ordered at any time. A more significant distinction is that as a result of the 1992 court of appeals decision,[55]

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[50]*See* 47 C.F.R. § 61.49(c), which requires filings that propose rates above the applicable SBI limits to be accompanied by supporting materials establishing substantial cause for the proposed rates.

[51]*Promotions NPRM*, 8 FCC Rcd at 3716.

[52]*Id.* at 3717.

[53]*See Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, 6824-25 (1990).

[54]*See* 47 C.F.R. §§ 61.44(g), 61.46(b), and 61.47(b).

[55]*See Reconsideration Order*, *remanded sub nom. American Telephone and Telegraph Company v. FCC*, 974 F.2d 1351, 1353 (D.C. Cir. 1992) (*Remand Order*).

promotions are incorporated into price cap calculations immediately upon effectiveness of the tariff, while new services are excluded from price caps until AT&T has obtained actual demand and revenue information concerning the service.

16. Commenters other than AT&T generally supported the Commission's proposals and tentative conclusions as set forth in the *Promotions NPRM*. They asserted that excluding the value of promotions from API calculations would protect one group of ratepayers from subsidizing the promotions that benefit another group of ratepayers[56] and would be consistent with the goals of price cap regulation.[57]

17. In opposing the proposals set forth in the Promotions NPRM, AT&T argued that its promotional tariffs are not different from other types of tariff filings and should be entitled to receive index credit under the Commission's price cap plan.[58] Moreover, AT&T argued that because none of its promotions has been rejected or suspended for violations of Sections 201(b) and 202(a) of the Communications Act, there is no justification for treating promotional tariffs differently from other price cap tariff filings.[59] AT&T also disputed the Commission's argument that including promotional tariffs in price caps will create the potential for cross-subsidization,[60] especially given their short duration.[61]

18. AT&T further contended that both MCI and Sprint have made extensive use of promotional offerings throughout the time that AT&T has been subject to price caps. AT&T argued that it therefore would be at a competitive disadvantage if the Commission did not permit it to receive index credits for promotions.[62] Finally, AT&T stated that it is required to disclose certain information about its promotions to the Commission. According to AT&T, it would be impossible to raise the API for its capped services above

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[56]Sprint Comments at 2-3; *see also* GTE Comments at 2.

[57]GTE Comments at 2.

[58]AT&T Comments at 10-11.

[59]*Id*. at 14-15.

[60]*Id*. at 11-12, *citing Reconsideration Order*, 6 FCC Rcd at 670.

[61]*Id*. at 12-13.

[62]*Id*. at 16-17 and Exhibit C.

the price cap index at the expiration of a promotion without prompt detection and immediate corrective action by the Commission.[63]

19. As discussed above, the Commission was initially silent on the issue of promotions. Our decision on the subject in the *Reconsideration Order* was then remanded by the court of appeals, and we have taken no action following the *Promotions NPRM*. In the meantime, AT&T has introduced new promotional offerings that expand the general class of discounts offered under the term "promotions." For example, the original class of promotions implemented by AT&T in 1989, which it submitted in a "generic" tariff, consisted of discounts on monthly usage charges.[64] These promotions were limited to designated services or to customers in specified geographic areas, and were of short duration, in some instances lasting no more than 90 days.[65]

20. In recent years, however, AT&T has introduced several widely-available mass-market discounts for domestic MTS, such as the current "True USA" and "True Rewards" (the "True promotions"). AT&T reported that, for calendar year 1994, 17 million customers enrolled in the True USA savings plan, and 14 million customers enrolled in the True Rewards program.[66] In addition, discounted interstate long-distance calls under the True promotions accounted for 53 percent of all minutes of consumer, *i.e.*, Basket 1, traffic on AT&T's network in 1994, whereas in 1993, interstate long-distance usage under discount plans that were in effect in that year accounted for 33 percent of Basket 1 traffic.[67] The True promotions also attracted an additional 1 million new customers for AT&T in 1994.[68] The amount of actual discounts off basic schedule domestic MTS rates to customers under the True USA promotion during the month of November 1994, alone,

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[63]*Id.* at 18.

[64]*See, e.g.*, AT&T Communications, Transmittal Nos. 1431 and 1552, Revisions to Tariff F.C.C. Nos. 1, 2, 4, 7, 9, 11, 13, and 14, 4 FCC Rcd 4475 (Com. Car. Bur. 1989).

[65]*Id.*

[66]*See AT&T Posts Earnings Increase*, Communications Daily, January 25, 1995, at 3.

[67]*Id.*

[68]*See* Edmund L. Andrews, *No-Holds-Barred Battle For Long-Distance Calls*, New York Times, January 21, 1995, at 48.

was \$265.3 million.[69] This unprecedented growth in AT&T's promotional activities has caused a major realignment in prices for Basket 1 services, especially basic schedule rates. Basic schedule ratepayers who have not elected a promotional discount plan have generally witnessed steady increases in their rates over the same period of time that AT&T has introduced mass-market promotions for residential customers.[70]

B. AT&T Optional Calling Plans

21. AT&T's promotional offerings to date have involved discounts based on its basic schedule MTS rates. Optional calling plans (OCPs) offer discounts or reduced rates for a specified period of calling to long distance customers in exchange for the customer's commitment to a fixed monthly charge or to participate for a minimum period of service.[71] Addressing AT&T's initial types of OCPs, for example, the Commission in the *OCP Guidelines Order* adopted the following definitions:

> Basic MTS: MTS service as it was offered pursuant to AT&T tariffs in effect before June 7, 1984, the effective date of the AT&T 'Block of Time' plan [citation omitted].
>
> Optional Calling Plan: A supplemental or additional MTS offering which allows customers to take MTS under an alternative, nontraditional pricing mechanism. For example, an OCP may offer service on a distance-insensitive basis or in bulk at reduced rate. An OCP may not involve changes to the rates or rate structure of the underlying basic MTS service.[72]

22. OCPs are usually designed to attract frequent callers who can take advantage of the discounts and other benefits to reduce their bills.[73] Examples of OCPs in the

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[69]*See* Letter, from M.F. Del Casino, Administrator -- Rates & Tariffs, AT&T, to Acting Secretary, Federal Communications Commission (Dec. 27, 1994).

[70]*See* discussion at para. 28, *infra*.

[71]By contrast, a typical mass-market promotion offered by AT&T requires enrollment or "self-selection," but does not usually bind a customer to a minimum payment or term of service.

[72]Guidelines for Dominant Carriers' MTS Rates and Rate Structure Plans, CC Docket No. 94-1235, 59 Rad. Reg. 2d (P&F) 70, 71-2 n.3 (1985) (*OCP Guidelines Order*).

[73]*OCP NPRM*, 8 FCC Rcd at 5205.

ReachOut service category include Block-of-Time (such as ReachOut America), AnyHour Saver, and EasyReach service.[74] MCI, Sprint, and a number of other interexchange carriers also offer discounted residential services that compete with these AT&T offerings.[75]

23. The price cap system's treatment of OCPs also differs from that accorded promotions. OCPs are included in a separate service category (the Reach-Out service category) from the basic MTS service categories within Basket 1,[76] whereas promotions are included in the applicable MTS service categories. Changes in OCP rates, therefore, are not subject to the SBI limitations on rate changes in the basic schedule service categories.

24. In the *OCP NPRM*, the Commission tentatively concluded that the ReachOut category of services (*i.e.*, most domestic MTS OCPs) should be removed from Basket 1 because there is substantial competition among providers of discounted residential services. The Commission noted that because rates for these services already appeared to be determined by market forces, not price cap limits, customers were unlikely to be harmed if the Commission made these services subject to streamlined regulation in the tariff review process. Moreover, customers would retain the option of choosing between AT&T's basic schedule or the discounted services of AT&T and other carriers.[77] The Commission also noted that to the extent that ReachOut services have had larger rate reductions than the standard long distance schedules for which they are substitutes, removal of ReachOut services from Basket 1 might encourage AT&T to target productivity gains to customers for the standard service.[78]

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[74]Examples of OCPs offered in other Basket 1 service categories are: international (ReachOut Overseas and USA Direct), operator/card (Card Only Plan 1), and day, evening, and night/weekend (Area Code Calling Plan).

[75]For example, Sprint offers Sprint Select; MCI offers such plans as Prime Time and Sure-Save.

[76]The majority of OCPs are offered in the ReachOut service category. AT&T now also offers certain OCPs in the other service categories in Basket 1. *See* note 72, *supra*.

[77]*OCP NPRM*, 8 FCC Rcd at 5205.

[78]*Id*. The PCI is adjusted each year to reflect a 3.0 percent productivity gain. To the extent that the price caps formula results in a lowered PCI, AT&T must reduce rates for Basket 1 each year to remain under the PCI. If OCPs were removed from Basket 1, the reduced rates required as a result of a lowered PCI would affect only the remaining services in the basket, and

25. The Commission sought comment on whether the treatment of OCPs under the AT&T price cap plan should be changed, and, if so, in what manner. Specifically, the Commission sought comment on whether it should adjust the API or the PCI for Basket 1 to reflect the removal of OCPs from Basket 1. As an alternative to removal of OCPs from price cap regulation, it asked for comment on whether OCPs should remain subject to price cap regulation, but be placed in a separate basket.

26. In its initial comments, AT&T supported removing OCPs from Basket 1 "without delay"[79] in order to gain the pricing flexibility it assertedly needs to respond to market conditions and customer demands.[80] AT&T also contended that if the Commission adopted new streamlined regulations for OCPs, it should not adjust the API or PCI to eliminate the "headroom" for Basket 1 services that AT&T would gain from this action.[81] In its reply comments, however, AT&T changed its position, and argued that, because the rates for residential OCPs and basic residential schedule services have been reduced significantly under price cap regulation, both categories of service should be removed from price caps and subject to streamlined regulation.[82] AT&T also opposed moving OCPs to another basket if they remained under price cap regulation.[83]

27. Although all commenters agreed that AT&T has maintained a market share for interstate traffic in the low 60 percent range for the past three years,[84] many commenters expressed doubts that reducing price cap regulation over AT&T would benefit

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therefore could potentially result in proportionally greater rate decreases for these services.

[79]AT&T Comments at i.

[80]*Id.* at 4.

[81]As discussed in the next section, headroom is the gap between AT&T's Actual Price Index (API) and its price cap index (PCI) ceiling for Basket 1.

[82]*Id.* at 9-10.

[83]*Id.* at 4.

[84]Comments regarding OCPs were filed by AT&T, Sprint Communications Company LP (Sprint), WilTel, Inc. (WilTel), the Competitive Telecommunications Association (CompTel), and Pacific Bell and Nevada Bell (Pacific Companies).

consumers.[85] Some commenters expressed concern that AT&T would use the $270 million in headroom that would result from removing OCPS from Basket 1 to raise prices on the remaining services in the basket.[86]

C. The "Headroom" Issue

28. Because mass-market promotions such as AT&T's True offerings are widely available to all customers, they can create apparent anomalies when calculating earnings and establishing indexes under the existing price cap plan. For example, AT&T may use the forecasted demand for its promotional plans to lower its adjusted price index (API) for Basket 1 services.[87] By substantially lowering the API,[88] AT&T's mass-market promotions also maximize the gap -- or "headroom" -- between AT&T's API and its price cap index (PCI) ceiling for Basket 1. AT&T's headroom in Basket 1 determines the extent to which AT&T can raise rates for non-discounted Basket 1 residential services without exceeding the PCI ceiling or the upper limits of its service band indexes (SBIs). Mass-market promotions, therefore, give AT&T the ability to offer widespread discounts to some residential services ratepayers, while increasing the basic schedule rates, without exceeding the SBI ceiling for the rate increases or dropping below the SBI floor with its promotional discounts.[89] If AT&T's basic schedule rate increase offsets the demand decrease caused by the higher basic schedule rates, AT&T would not forego any revenues as a result of its promotional offerings.

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[85]Sprint Comments at 3; Sprint Reply at 2; *see also* CompTel Comments at 2; WilTel Comments at 3; Pacific Companies Reply at 3-5.

[86]WilTel Reply at 2.

[87]*See generally* 47 C.F.R. §§ 61.44, 61.46.

[88]For example, as of July 1, 1994, AT&T's headroom under the PCI in Basket 1 amounted to $1.12 billion on an annualized basis. Under Section 61.46(a) of the rules, when AT&T adjusts a rate, the demand component used to calculate the API remains constant at the base year level. AT&T's headroom is thus calculated based on 1993 demand multiplied by rates as of July 1, 1994 for Basket 1 services. AT&T's True promotions accounted for $893.5 million of this annualized headroom. *See, e.g.*, Letter from Thomas H. Norris, Vice President, Regulatory Affairs, AT&T, to Acting Chief, Common Carrier Bureau, Federal Communications Commission (Aug. 15, 1994).

[89]*See* notes 80, 97, *infra*.

29. The headroom that permits these basic rate increases is, moreover, predicated upon forecasts of the expected demand for the promotional offerings. Currently, AT&T forecasts its demand for the life of the promotion at the time the promotion is filed. An error in this forecast could permit AT&T to adjust the API downward based on forecasts for higher demand for a promotion than actually materialize. In such a situation, AT&T would be able to increase its basic rates more sharply than if actual demand were used to calculate the effect of the promotional offering on the API. Customers of basic schedule service consequently are charged more for service when AT&T's forecasts for promotions are higher than actual demand. No mechanism exists under the price cap rules to correct for any inaccuracies in forecasted demand, although AT&T has committed from time to time to "true up" its headroom calculation based on actual demand.[90] AT&T, however, is not required to refund overcharges to customers of basic schedule service.

30. AT&T has increased its basic schedule rates in Basket 1 during the past two years concurrently with the implementation of its True promotion offerings. For example, on December 5, 1994, AT&T implemented an average rate increase in basic schedule MTS rates of 3.9 percent, valued at $274 million.[91] On December 27, 1994, AT&T also raised rates for optional calling plans, operator/card services, and international MTS (IMTS) within Basket 1 by approximately $260 million.[92] Increases in AT&T's basic schedule rates are also reflected in studies conducted by Commission staff, which are based on the Bureau of Labor and Statistics's (BLS) consumer price index (CPI) and producer price index (PPI) for interstate toll calls from 1984 through May, 1994. The Commission staff study, released in May, 1994, found that AT&T's basic schedule rates increased by 6.5 percent for calendar year 1993 and 9.3 percent from March 1993 through March 1994, based on the BLS-maintained consumer price index (CPI) for interstate toll services.[93] A study completed by Commission staff in February, 1995, which addresses

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[90]*See, e.g.*, Letter from Thomas H. Norris, Vice President, Regulatory Affairs, AT&T, to Acting Chief, Common Carrier Bureau, Federal Communications Commission (Jan. 15, 1994).

[91]*See* AT&T Communications Transmittal Nos. 7824, 7832, 7848, Revisions to Tariff F.C.C. No. 1 (December 5, 1994); *see also AT&T Proposes $274 Million in Domestic Price Hikes*, Telecommunications Reports, December 12, 1994, at 41.

[92]AT&T Communications Transmittal No. 7967, Revisions to Tariff F.C.C. No. 1 (Dec. 27, 1994).

[93]*See Trends in Telephone Service* (Industry Analysis Div., released May 1994).

AT&T's long distance prices through year-end 1994, finds that the CPI for AT&T's interstate toll calls increased a total of 5.4 percent in 1994.[94]

31. AT&T has informally objected to the use of the CPI and PPI as measures of rate changes. AT&T contends that the indices are not reliable indicators of overall long distance pricing performance because they do not adequately reflect the offsetting effect of discount plans.[95] The Commission staff study released in February, 1995, for example, states that the CPI for interstate toll services, as computed by BLS, overstate the increases in average charges because the CPI sample underweights discount plans and the PPI sample excludes discount plans.[96] It is clear, nonetheless, that the overall increases in basic schedule rates, when compared with the significant discounts in AT&T's True promotions, have created a wide range in prices for Basket 1 residential services. The issue posed below is whether this realignment in prices to residential subscribers in the MTS categories, which are not substantially affected by such price cap mechanisms as the SBI limits and the residential rate index,[97] requires revisions to the price cap system.

D. Reclassification of AT&T as a Non-Dominant Carrier

32. The Commission based its tentative conclusions in the *OCP NPRM* and the *Promotions NPRM* to remove OCPs and promotions from Basket 1 primarily on findings that such treatment would not hinder competition for OCPs and would deter AT&T from

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[94]*See Trends in Telephone Service*, at Table 5 (Industry Analysis Div., released Feb. 1995).

[95]*See* Letter of Thomas H. Norris, Vice President, Government Affairs, AT&T, to Chairman, FCC (June 10, 1994) (criticizing use of CPI as indicator of basic schedule rates on grounds that it takes into account only basic schedule rates, and not the offsetting effect of discount plans); Adam Clymer, *As Parties Skirmish Over Budget, Greenspan Offers a Painless Cure*, New York Times, January 11, 1995, at 1, 18 (testimony by Chairman of Federal Reserve Board before joint meeting of House and Senate Budget Committees that the overall CPI exaggerates annual inflation by 0.5 to 1.5 percentage points because ten-year adjustment period for CPI fails to capture fully such changes as suddenly successful inventions like television sets or the introduction of more sophisticated computers, which reduce prices and enhance efficiency).

[96]*See Trends in Telephone Service*, at Table 5 (Industry Analysis Div., released Feb. 1995).

[97]AT&T is required under current rules to calculate a composite average rate for Basket 1 services purchased by residential customers. This rate may not increase more than one percent relative to the annual percentage change in the Basket 1 PCI. *See* 47 C.F.R. § 61.47(g).

using promotions anti-competitively.[98] Since the release of the *OCP NPRM* and the *Promotions NPRM*, however, AT&T has filed a motion requesting that it be reclassified as a nondominant carrier.[99] AT&T argues in its petition that circumstances have changed since the time it was originally classified as a dominant carrier, including the divestiture of the Bell System's bottleneck local facilities and the increase in interexchange carriers, resulting in "thriving" and "robust" interexchange competition.[100]

III. DISCUSSION

A. Commission Goals

33. The Commission's primary goals in applying price cap regulation to AT&T include ensuring just and reasonable long distance rates for ratepayers, without unreasonable discrimination,[101] as well as promoting the universal availability of such reasonably priced service.[102] Moreover, the Commission's price cap plan for AT&T is intended to afford AT&T the flexibility to adjust prices to approximate more closely

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[98]*See* discussion at paras. 12-19 and 23-26, *supra.*

[99]*See* Motion for Reclassification of American Telephone & Telegraph Company as a Nondominant Carrier, CC Docket 79-252 (filed Sept. 22, 1993). This motion is still pending before the Commission.

[100]*See id.*

[101] *See* 47 U.S.C. §§ 201(b), 202(a). In deciding to establish an incentive-based system of regulation for AT&T, the Commission found in the *AT&T Price Cap Order*, for example, that:

> price cap regulation is a far better regulatory system to employ in an environment in transition to full competition than is rate-of-return . . . . [T]he discipline that competition brings to a carrier's prices can be employed in the design of a price cap system to ensure that rates are just, reasonable, and non-discriminatory.

4 FCC Rcd at 2939-43 (footnotes omitted); *see also Promotions NPRM*, 8 FCC Rcd at 3716.

[102]*See* 47 U.S.C. § 151. In the *AT&T Price Cap Order*, the Commission referenced its adoption of universal service as one of the four primary goals in the access charge proceeding *MTS and WATS Market Structure*, 97 FCC 2d 834, 835 (1984), and reconfirmed its commitment to residential customers in adopting price cap regulation. 4 FCC Rcd at 3053-4.

marginal costs and to encourage innovation and the introduction of new services.[103] The primary focus of this Further Notice, therefore, is to determine whether the existing price cap plan should be modified to ensure that promotions and Optional Calling Plans (OCPs) advance the Commission's public interest goals. In addition, we seek to adopt a regulatory scheme for promotions and OCPs that will continue to foster greater competitiveness in the interexchange market and to permit us to remove more of AT&T's services from price cap regulation.[104]

34. To these ends, we seek to reduce regulatory burdens on AT&T that do not serve the public interest goals of our price cap plan for AT&T. Moreover, our intention is to provide AT&T with greater flexibility to respond promptly to developments in the interstate interexchange marketplace. We also want to simplify price cap procedures and reduce periods of delay caused by the tariff review process. In addition, we seek to ensure that our price cap scheme for AT&T treats like services in a sensible, consistent manner. Finally, as discussed below, we seek comment on the degree of protection that the price cap plan should afford AT&T subscribers who obtain domestic MTS from basic rate schedules.

35. We tentatively conclude that at the present time these goals would not be served by removing AT&T's current Basket 1 promotions and OCPs from price cap regulation. As discussed below, we tentatively conclude in this Further Notice that Basket 1 domestic MTS promotions, domestic MTS OCPs, and basic schedule MTS offerings exhibit substantial cross-elasticities of demand, and are generally offered to the same class of customers, *i.e.*, residential customers, following the removal of AT&T's commercial services from price cap regulation. The removal of domestic MTS OCPs and promotions from price caps would thus streamline some AT&T offerings of domestic MTS for residential customers and retain price cap regulation for similar offerings to the same class of customers.[105] We decline to take such a step at this time and, contrary to the tentative conclusions of both the *Promotions NPRM* and the *OCP NPRM*, we now tentatively conclude that the issue of further streamlining of OCPs and promotions should

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[103]*See id.* at 2922-33.

[104]*See id.*

[105]In our decisions to streamline AT&T's commercial services and outbound business services, we were able to differentiate these services from those services remaining in price caps on the basis of, among other things, the class of customers to whom those services were offered, and the demand elasticities among these classes of customers. *See Commercial Services Price Cap Order*, FCC 95-18 at paras 15, 20-21; *Interexchange Order*, 6 FCC Rcd at 5887-88.

be considered together with AT&T's motion for non-dominant status in a separate proceeding. We believe that the regulatory status of OCPs and promotions should be considered as part of the larger issue raised by AT&T's motion: whether all of the services that currently are included in Basket 1 should be removed from price cap regulation and afforded streamlined regulatory treatment. We invite comment on these tentative conclusions.

B. Proposed Revisions to the AT&T Price Cap Plan

36. Having tentatively concluded that neither OCPs nor promotions should be removed from price cap regulation at this time, we now consider whether any modifications to the existing price cap plan would advance our public interest goals more effectively. We seek comment on the tentative conclusions and issues described below.

37. Definitional Issues. As discussed in the background section of this Further Notice, no precise definition of promotions has been included in our price cap rules. It is clear, however, that the effects of mass-market promotions were not contemplated when we formulated the baskets and bands that restrict AT&T's pricing practices. Furthermore, although we have defined OCPs, the services covered by this definition are very similar to self-selected promotions in that OCPs offer a discounted alternative to basic schedule MTS. Accordingly, we tentatively conclude that self-selected promotions and OCPs should be treated in the same manner under our price cap rules. We propose to establish a new regulatory category for self-selected promotions and OCPs: "alternative pricing plans" (APPs). The defining characteristic of an APP is that it offers a self-selected alternative, *i.e.*, discounted rate, to domestic MTS or other price cap services provided under basic schedule rates.

38. We also conclude that an APP does not differ from an existing service in the domestic MTS service category, and possibly in the other Basket 1 service categories as well, except in ways related to pricing and terms and conditions affecting pricing. APPs are thus "like" existing domestic MTS services.[106] Although we have previously rejected

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[106]Services are "like" if they are "functionally equivalent," that is, if a customer perceives that the services perform the same function. *See Ad Hoc Telecommunications Users Com. v. F.C.C.*, 680 F.2d 790, 797 (1982). Services need not be "identical" to be functionally equivalent. In the context of mobile services, for example, the Commission has held that the "principal inquiry" in determining whether two services are functionally equivalent involves "evaluating consumer demand for the service" and "whether changes in price for the service under examination . . . would prompt customers to change from one service to the other." *See* Implementation of Sections 3(n) and 332 of the Communications Act; Regulatory Treatment

the notion that only services offering new functional capabilities be treated as "new,"[107] we believe that our rules for the treatment of new services should not apply to APPs, as we discuss below. For example, we propose allowing AT&T to file an APP on a streamlined basis, without cost support, outside of price cap regulation. A streamlined APP would expire automatically 90 days after its effective date unless AT&T would file a transmittal with actual cost and demand revenues for the initial 90-day period, subject to tariff review and approval, to include the APP as a permanent offering under price cap regulation.[108]

39. We also tentatively conclude that alternative pricing plans are, by definition, not restructured services. A restructured service is one that replaces an existing service, whereas an APP offers an alternative to an existing service without replacing it. Moreover, a restructured service is automatically available to anyone who simply uses basic schedule MTS, whereas an APP is available only to an eligible customer who signs up for the service. Under this approach, we would tentatively conclude that services that AT&T currently labels "promotions" that automatically change MTS rates without creating additional options, even if for a limited period or for limited locations, should be treated as restructures, not alternative pricing plans, and should be subject to price cap regulation as soon as the tariff becomes effective.[109] In contrast, an alternative pricing plan, such as any of AT&T's True promotions, does not replace the underlying basic rate, but rather provides an optional discount off the basic rate that a customer can "self-select." We seek comment on these tentative conclusions. We also seek comment on whether our definition of APPs and the proposed rule changes guiding the regulatory treatment of APPs outlined below should be applied to the IMTS and operator/card service categories.

40. Basket 1 Service Categories. In light of our decision to remove commercial services from price caps and our tentative conclusions discussed above concerning alternative pricing plans, we believe it is appropriate to examine the existing Basket 1

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of Mobile Services, Second Report and Order, GN Docket No. 93-252, 9 FCC Rcd 1411, 1447-48 (1994).

[107]*See AT&T Price Cap Order*, 4 FCC Rcd at 3123 n. 1103 (holding that repriced version of already-existing service cannot be considered the same service as the pre-existing one).

[108]*See* discussion at para. 46-57, *infra*.

[109]For example, under the proposed approach, the Cinco de Mayo "promotion," which offers a discounted MTS rate to anyone who calls from the United States to Mexico on May 5th, would be treated as a restructure of MTS rates for a one-day period.

service categories in order to determine whether any modifications to them are necessary. We tentatively conclude, for the reasons set forth below, that the four existing domestic MTS service categories in Basket 1 -- namely, (1) domestic day MTS; (2) domestic evening MTS; (3) domestic night/weekend MTS; and (4) ReachOut America -- should be combined as a single service category. If this restructuring were implemented, AT&T's Basket 1 would consist of three service categories: (1) domestic MTS, including all three current time-of-day MTS categories, OCPs in the existing ReachOut America category covering domestic MTS and domestic MTS promotions (in other words, domestic MTS basic schedule services and APPs as discussed above); (2) operator and credit card services; and (3) international MTS.

41. We believe that establishing a single domestic MTS service category to encompass the existing time-of-day MTS service categories as well as APPs will increase AT&T's pricing flexibility and better reflect the realities of the interexchange market. We note, for example, that interstate access rates, which appear to be a major component of AT&T's marginal costs of providing service, are not time-of-day-sensitive[110] and thus do not track pricing differences among AT&T's domestic MTS categories. We also observe that removal of Basket 1 commercial services from price cap regulation would appear to make our conclusion that residential callers are the predominant users of evening and night/weekend MTS equally applicable to day MTS.[111] There is thus no significant differentiation by class of customer in the three domestic MTS service categories. We seek comment on whether a single domestic MTS category or retention of the day, evening, and night/weekend structure is appropriate.

42. When we first authorized AT&T to offer optional calling plans which met an increased net revenues standard, we recognized the existence of cross-elasticities of demand in switched services, and the importance of information about cross-elasticity of demand in the evaluation of OCPs.[112] Cross-elasticity of demand between basic schedule domestic MTS and AT&T's mass-market True promotions is implicit in the headroom calculations AT&T presents as the result of these promotional offerings; these reductions in the API and relevant SBIs involve revenues "foregone" because of a shift by customers from basic schedule rates to promotional rates in the domestic MTS service categories,

[110]The LECs do not charge access rates according to time of day.

[111]*AT&T Price Cap Order*, 4 FCC Rcd at 3060.

[112]*OCP Guidelines Order,* 59 Rad. Reg. 2d (P&F) at 83.